Missouri Division of Finance

UPDATE

A Report of Missouri State Chartered Financial Institutions

Issue 00-1 **April 2000**

From . . .
Acting Commissioner
D. Eric McClure

The condition of Missouri State chartered banks continues to be very good. The industry successfully met the Y2K challenges and entered the new millennium with good solid financial footings. The economy continues to be relatively strong. However, rising interest rates, low commodity prices, and fierce competitive pressures are all challenges to the ongoing safety and soundness of our financial industry. New financial modernization laws along with explosive Internet growth will provide additional opportunities as well as challenges.

Our dual banking system is unique in this world and is often not fully recognized and appreciated. We are proud to be a part of this system which balances regulatory power and fosters efficiency, flexibility, and innovation. The State charter is alive and well in Missouri and there continues to be new charter activity which is exciting.

Our consumer credit and mortgage broker sections continue to handle an ever-increasing number of licenses. We are in the process of increasing our staffing to help meet these additional challenges.

We hope this edition of the *UPDATE* will be of value to you. We welcome feedback regarding what you would like to see in future editions. Make sure to visit our website, which is constantly being improved and contains a lot of good useful information.

GENERAL USURY

Section 408.030 provides that the Director of Finance shall declare the quarterly market rate of interest each quarter, post it in accordance with Section 361.110 and publish it in appropriate publications. Said quarterly market rate for the period April 1, 2000 through June 30, 2000 shall be 9.5%; as an alternative, 10% may be used.

In This Issue

NEW STATE BANKING BOARD MEMBERS NAMED

Governor Carnahan's office has announced the appointment of two new State Banking Board members:

Appointed to a term ending August 28, 2001 and until his successor is appointed and approved is ***Mr. Robert Robuck***, President and CEO of Central Trust Bank in Jefferson City. Mr. Robuck replaces Mr. Corwin Ruge who resigned from the Board.

Appointed to a term ending August 29, 2003 and until her successor is appointed and approved is ***Ms. Kathleen M. Meyer*** of Troy, Missouri, co-founder of Meyer Title Company. Ms. Meyer replaces Mr. Al Nilges who resigned from the Board.

FHLB LEGAL LOAN LIMIT QUESTION

Bonds and other evidences of debt issued by the Federal Home Loan Bank, which are not guaranteed by the United States Government, are not exempt from the state's legal loan limit. While the Division has recently cited several violations due to investments in these instruments and those of other federal agencies beyond a bank's legal loan limit, the Division has not required the divestiture of existing investments at this time, pending the outcome of legislation before the General Assembly that could create an exemption. In the meantime, the Division has strictly prohibited any additional investments beyond a bank's legal loan limit in these types of instruments. Please contact Lawrence C. Clos, our Chief Examiner in Jefferson City (573-751-4297) if you have questions regarding your institution's holdings.

INPUT SOUGHT ON GRAMM-LEACH-BLILEY ISSUES

The Division of Finance is soliciting questions and comments from Missouri banks regarding new powers and activities that state banks may be considering due to the federal financial modernization legislation, Gramm-Leach-Bliley. To date, the Division has worked with individual bankers on specific questions that have been posed, but would like to receive more input from bankers around the state on this subject to analyze our regulations and statutes and identify any needed updates or changes. Please send any input, including comments or questions, that you may have regarding powers and activities that your institution, its subsidiaries or affiliates may be interested in exploring to Greg D. Omer, Chief Counsel, Missouri Division of Finance, P.O. Box 716, Jefferson City, Missouri 65102. We hope to receive all the input by April 30, 2000.

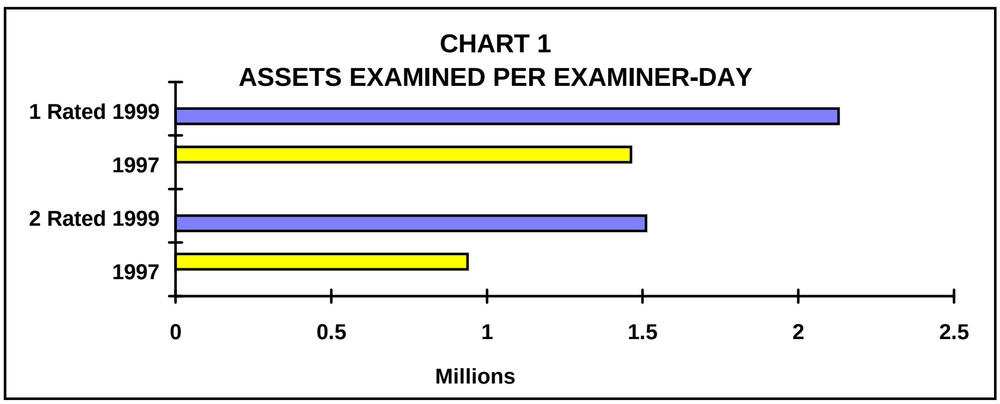
EFFICIENT AND EFFECTIVE BANK EXAMINATIONS

Several years ago the Division of Finance initiated examination procedures aimed at improving both the effectiveness and efficiency of bank examinations. This program has been successful in achieving goals of maintaining examination quality, ensuring efficiency, reducing indirect costs to the bank (such as employee time spent working with examiners) and fast delivery of the final written report. These goals have been achieved by the hard work of our staff, sharpening the risk focus of each examination and utilizing advanced technology.

GOAL: High Quality

RESULTS:

- *Pre-examination review and planning methods allow examiner flexibility to tailor procedures for the unique risk areas of each bank.*
- *Utilization of the GENESYS computerized examination report system integrates data from Uniform Bank Performance Reports, Call Reports, and prior examinations into one program to help create the report.*
- *Employment of ALERT software that provides examiner versatility in analyzing loan account information.*
- *Emphasis on making recommendations of value to management.*



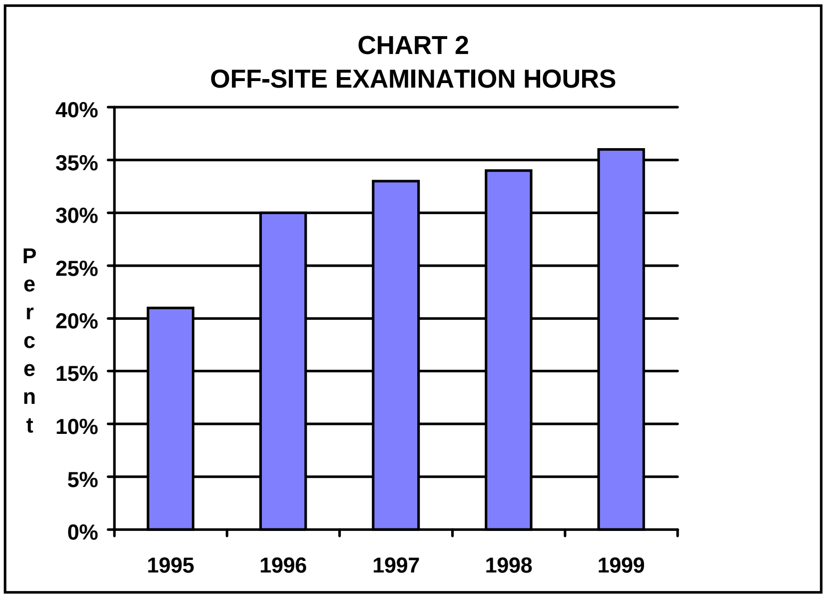
GOAL: Reduce Burden on 1 Rated Banks (Chart 1)

RESULTS: The state's strongest banks receive the most benefit from risk focused examination procedures. Chart 1 shows that in 1999, 41% more assets examined per day in a 1 rated bank than a 2 rated bank. This equates to shorter examinations for 1 rated institutions.

GOAL: Efficiency (Chart 1)

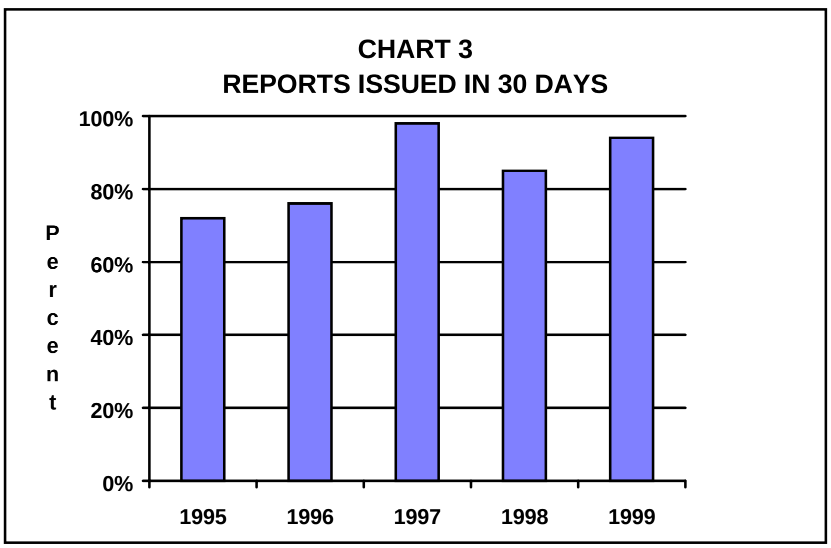
RESULTS:

- *We strive to plan, budget and complete every examination as efficiently as possible. The hours of each examination are measured against established targets. In addition, we minimize the time bankers spend responding to examiner needs, particularly information requests and meetings.*
- *Chart 1 compares 1999 efficiency measures against our performance at the prior State examination (for the year 1999, the prior State examination was usually in 1997). The measure is the ratio of Assets Examined Per Examiner-Day. Assets Examined Per Examiner-Day increased 46% over the prior examination for 1 rated banks. In banks rated 2, the measure rose 61%.*



GOAL:
Minimize On-site Examination Hours (Chart 2)

RESULTS:
Examiners are completing as much of their review as possible in our offices to reduce intrusion on normal bank activity. Chart 2 shows 36% of total hours for examinations are conducted outside the bank - an increase of 9% over 1997.



GOAL:
Promptly Issue Examination Reports (Chart 3)

RESULTS:
For the quarter ending 12/99, 94% of routine examinations were mailed to the Board of Directors within 30 days of examiners leaving the bank. Prompt receipt of the final report allows directors to review fresh information and relevant recommendations.

DIVISION OF FINANCE WARNS OF FRAUDULENT LOANS

The Missouri Division of Finance is warning Missouri consumers to beware of so-called advance fee loan scams which originate in Canada.

Traditionally, the con artist runs ads in free publications, offering unsecured loans regardless of credit. The consumer is invited to call a toll-free number, provide credit information, and wait for a return call. When the call is returned, the consumer is told that the loan has been approved, usually at a very favorable rate and with a monthly payment the borrower can handle. The victim is asked to send a brokerage fee ranging from several hundred to several thousand dollars by cashier's check or money order overnight via UPS or Federal Express to complete the deal. The "fee" is then pocketed and, of course, there is no loan.

"Collecting brokerage fees in advance of making the loan is illegal in Missouri," said Eric McClure, Acting Commissioner of Finance. "So, right off there is a clue that the broker is not on the level. People who send money find that the company's telephone is no longer in service just a few days later. We do not know of anyone who has ever received a loan through one of these operators."

According to the Division of Finance, the scam is still on-going, and the con artists are becoming more savvy. When asked to supply an address, the con artist will give an American address as the location of all but the processing office. The address is usually in a good business neighborhood, but never in the same state as the victim. The Division investigated two such addresses in Missouri and determined that one was a vacant lot and the other did not exist.

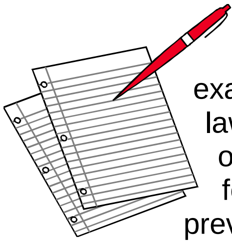
The Division became involved in the scam investigation after being contacted by residents of other states who inquired about the legitimacy of Capitol Investments of St. Louis. Investigation by the Division found that Capital Investments, LLC of St. Louis is a legitimate corporation, but has no affiliation with the loan scam. The company addresses given to the victims did not match Capital Investments' actual address.

"Caution and common sense are the best defenses against being victimized," said McClure. "If you are creditworthy, there are hundreds of lenders in this state who are happy to serve you. Time is the only thing that will repair bad credit."

The Canadian government is aware of the scam and is conducting an investigation. Inquiries into the Canadian investigation should be directed to Phone Busters at 1-888-495-8501. They may also be reached via e-mail at phonebuster@efni.com

If you have any information regarding the advance fee loan scam or have been victimized, please contact Phone Busters or the Consumer Protection Hotline in the Missouri Attorney General's office at 1-800-392-8222.

TOP FIVE VIOLATIONS



We reviewed 234 commercial bank examination reports of Missouri state-chartered banks in order to identify the most frequent infractions of law. The examinations were conducted in 1999. We recognize compliance with all the banking laws and regulations is a daunting task for any manager and most infractions are oversights. However, 28% of the banks had no violations - *it is possible*! The following table highlights areas your institution may want to re-look in an effort to prevent inadvertent violations.

Frequency	**Law or Regulation**	General Type of Infraction
24%	**Regulation O** ***Insider Lending***	**Overdrafts, failure to identify related interests, prior loan approvals, loans exceeding limits, failure to identify debt at other banks.**
18%	**110.010 RSMo** ***Public Funds***	**Failure to pledge sufficient securities to secure deposits of public entities.**
16%	**Part 326, FDIC Rules** ***Bank Secrecy Act***	**Failure to monitor currency transactions, inadequate internal testing for compliance, inadequate training of personnel.**
14%	**Part 323, FDIC Rules** ***Real Estate Appraisals***	**Failure to obtain certified appraisals, lack of evaluations of real estate value where certified appraisal not required.**
14%	**362.275 RSMo** ***Board Minutes***	**Failure to review required lists of indebtedness, collateral not included on board lists, unfunded loan amounts omitted from insider indebtedness list.**

CHECKED OUT OUR WEB SITE LATELY?

Our **new address** makes us easier to find. Just point your browser to ***www.missouri-finance.org*** and click into our storehouse of information.

You will find listings and addresses of every financial institution and consumer licensee regulated by the Division of Finance. There is a banking location finder with an interactive map so you can locate all banking locations in a particular county.

All of our publications (including this issue of the ***UPDATE***) are available, along with numerous forms and applications.

Questions about banking laws and regulations? You may find the answer here, along with many useful and informative links.

This service is for you; give it a try! We are constantly improving the site and will welcome your comments and suggestions.

1999 EXAMINERS' BANKING PRACTICES SURVEY

During each examination, Division of Finance examiners complete a survey that provides the Commissioner additional insight into current banking practices in state banks. The purpose of the survey is to solicit examiner impressions regarding general areas of lending, investments, funding and other activities. The responses provide early signals of changes in practices of Missouri's state-chartered banks.

HIGHLIGHTS

- An increasing number of banks experiencing strong loan growth, particularly in real estate construction, land development and commercial projects.
- A slight upward trend in banks willing to undertake "more-than-normal" risk in originating loans. The most frequent underwriting risk was inordinate reliance on the estimated collateral value, which suggests inadequate consideration to cash flow and financial data.
- The classifications-to-capital ratio increased in 56 percent of banks surveyed by an average of eight percent. The source of deterioration was primarily in older established credits. Classifications were chiefly residential real estate and consumer loans.
- A substantial increase in banks relying on Federal Home Loan Bank funding - now at 57 percent.
- 50 percent of banks surveyed generate fee income from non-traditional activity, with the most prevalent non-deposit investment sales.

	1997	1998	1999
Number of Bank Surveys	115	125	135
LENDING			
Increased lending activity by at least 20% since the last examination.	38%	41%	44%
• **Of banks that increased lending activity at least 20%, the activity occurred in the following areas:**			
RE/Construction/Land Development	16%	17%	19%
RE/Agricultural	7%	10%	9%
RE/Commercial/Industrial	20%	19%	19%
RE/Residential	33%	14%	17%
Agricultural	5%	8%	6%
Commercial/Industrial	10%	17%	16%
Consumer	9%	15%	14%
• **Increased activity from participations or out-of-territory loans**	6%	5%	8%
Making loans in high-risk segments.	NA	NA	13%
• Of banks that loan to high-risk segments, the activity occurred in the following areas:			
Subprime			5%
Dealer paper			73%
Low or no-documentation business loans			18%
High loan-to-value home equity lending			4%
Offering below market interest rates or reduced rates to attract loans.	5%	5%	6%
Incurring "more-than-normal" risk in underwriting to book new loans.	16%	21%	23%
• Of banks incurring more-than-normal risk, specific practices are:			
Collateral based loans	22%	24%	27%
Reduced collateral margins	14%	24%	19%
No cash flow projections	17%	22%	19%
Liberal repayment terms	19%	17%	16%
Waiving guarantees or documentation	6%	4%	7%
Other	22%	9%	12%

	1997	1998	1999
Current underwriting practices represent:			
More-than-normal risk	**10%**	**13%**	**10%**
Substantial risk	**2%**	**0%**	**2%**
Differences between actual lending practices and written policies are considered:			
Moderate	**14%**	**19%**	**18%**
Substantial	**1%**	**3%**	**2%**
Credit scoring models used for loan decisions.	**NA**	**NA**	**8%**
• **Of banks using credit scoring, types of loans scored are:**			
Credit card			**20%**
Consumer			**33%**
Residential real estate			**20%**
Small business			**7%**
Other			**20%**
The classifications-to-capital ratio increased from the prior examination.	**NA**	**NA**	**56%**
• **Average increase in the classification ratio.**			**8%**
• **Causes of increased classifications are:**			
Eased underwriting standards			**11%**
Deterioration in new loans			**13%**
Deterioration in older loans			**45%**
Participations or out-of-territory credits			**2%**
Economic conditions			**12%**
Changes in lending personnel			**2%**
New types of lending activity			**1%**
Other			**14%**
• **Loan classifications are of the following types:**			
RE/Construction/Land Development			**8%**
RE/Agriculture			**12%**
RE/Commercial			**15%**
RE/Residential			**20%**
Agricultural			**10%**
Commercial/Industrial			**16%**
Consumer			**19%**
INVESTMENTS			
Purchased securities without a full understanding of the characteristics of the issue.	**0%**	**1%**	**4%**
Differences in actual investment practices and written policies are considered:			
Moderate	**3%**	**5%**	**8%**
Substantial	**0%**	**0%**	**1%**
FUNDING			
Borrowing line established with the Federal Home Loan Bank.	**39%**	**43%**	**57%**
• **Of banks that have borrowing lines, those actively borrowing are:**	**64%**	**52%**	**75%**
Issued structured (tiered/multiple step-up) certificates of deposit.	**1%**	**3%**	**5%**
OTHER			
Hold off-balance sheet derivatives.	**1%**	**1%**	**2%**
Engaged in nontraditional fee-based activity.	**37%**	**39%**	**50%**
• **Of banks engaged in fee-based activity, types are:**			
Nondeposit investment sales	**68%**	**67%**	**62%**
Insurance sales	**20%**	**22%**	**25%**
Other	**12%**	**11%**	**13%**

Missouri State Banking - A Picture of Success

Missouri state chartered banks ended the century with continued strong growth and performance, paralleling the national and state economies. At year-end 1999, 315 state chartered banks held $34.7 billion in assets and $28.8 billion in deposits. This is only a slight change from the previous year-end when 333 banks held $33.6 billion and $28.4 billion assets and deposits. During 1999 sixteen banks left the state banking system through merger or consolidation. The remaining 315 banks grew 8.2 percent. This is quite favorable considering the industry's national growth was 5.4 percent, and both the state and national Gross Domestic Product grew an estimated 3.4 percent.

Return on assets for Missouri state banks in 1999 was considered to be solid at 1.19%, compared to 1.20% in 1998.

Asset quality indicators continue to show little evidence of deterioration. Nonperforming loans continue to be at historically low levels, and have been declining all year. At year-end, these loans represented 0.67% of total loans, compared to 0.94% nationally.

Net charged off loans to total loans remained low and steady at 0.19% in 1999 (1998 and 1997 were 0.17% and 0.20% respectively). The national charge off rate was 0.63% in 1999 and 0.37% in 1998.

Selected performance measurements of Missouri state chartered banks are depicted below:

	Missouri State Banks	
	1999	**1998**
Yield on Earning Assets	7.89	8.13
Cost of Funding Earning Assets	3.75	3.98
Net Interest Margin	4.14	4.15
Credit Loss Provision to Average Assets	.21	.18
Return on Assets	1.19	1.20
Net Charge offs to Loans	.19	.17
Non performing Loans to Total Loans	.67	.78
Efficiency Ratio	58.43	58.24
Tier 1 Leverage Ratio	9.11	9.24
Loans to Assets	68.07	64.40
Earning Assets to Total Assets	92.18	92.33

Missouri state chartered banks are regarded to be in excellent financial condition with very strong capital levels. In 1999 only eight state chartered banks (2.5%) were unprofitable (six of the eight were recently chartered). Additionally, Missouri state banks subject to formal enforcement actions are at a record low.

The state banking system is considered robust and well positioned to lead Missouri into the next millennium.

First Missouri State Charter of the 2000s

The Missouri Division of Finance welcomes its latest state chartered bank: The Branson Bank, chartered February 17, 2000 and opened March 22, 2000 at 1501 State Highway 248, Branson. Initial capital: $3,214,500.